Supreme Court, U.S.
FILED
NOV 4 1991
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No. 91-571

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1991

ROBERT J. TAYLOR, Trustee,
Petitioner,

v.

FREELAND & KRONZ, a Partnership; WENDELL G. FREELAND; and RICHARD F. KRONZ,
Respondents.

Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Third Circuit

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a trustee, who has never objected to the debtor's claim of exemption, may attack that claim of exemption, years after the debtor's discharge, when § 522(l) of the Bankruptcy Code provides, unless a party in interest objects, what is claimed as exempt is exempt?

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STATUTE AND RULES INVOLVED

Respondents supplement petitioner's statute and rules involved as follows.

Section 522 of the Bankruptcy Code, 11 U.S.C. § 522 (1988) provides in pertinent part:

> (a) In this section -
>
> (2) "Value" means fair market value as of the date of the filing of the petition or, with respect to property that becomes property of the estate after such date, as of the date such property becomes property of the estate.

Rule 9006(b)(3), Federal Rules of Bankruptcy Procedure, provides in pertinent part:

> (3) Enlargement Limited. The court may enlarge the time for taking action under Rules 1006(b)(2), 1017(e), 3002(c), 4003(b), 4004(a), 4007(c), 8002, and 9033, only to the extent and under the conditions stated in those rules.

STATEMENT

Respondents supplement and correct petitioner's statement of the case below.

The employment discrimination lawsuit, which the debtor claimed as exempt, began in April of 1978, when Emily Davis ("Davis" or "debtor"), through her attorney, Clenncy Cotton, filed a complaint with the Pittsburgh Commission on Human Relations ("Commission"). The case was tried before the Commission and it found in favor of Ms. Davis by order dated December 16, 1980.

The Commission ordered Trans World Airways ("TWA"), the debtor's former employer, to pay the debtor's wage loss differential from March, 1976 until the date TWA no longer employed senior sales representatives in the Pittsburgh Office. TWA was to submit information to the Commission for the calculation of wage loss (Appendix filed with the Third Circuit, hereinafter "Record on Appeal" (ROA), at 101-). TWA did not provide some of the wage information until the spring of 1987 (ROA 298-301).

TWA appealed the Commission order to the Court of Common Pleas of Allegheny County, Pennsylvania ("Common Pleas"), alleging there was insufficient evidence to support a finding of discrimination (ROA 103-111). After TWA filed its appeal to Common Pleas, Freeland & Kronz were asked to represent Ms. Davis (ROA 271-272). Wendell Freeland agreed to represent Ms. Davis for forty (40%) percent of the proceeds of

any recovery (ROA 40, 272). Common Pleas reversed the Commission's decision on liability (ROA 111). On appeal, the Commonwealth Court of Pennsylvania reversed the Common Pleas and reinstated the order of the Commission. TWA then petitioned the Supreme Court of Pennsylvania for allowance of appeal which was granted in November of 1983 (ROA 294).

As of October 24, 1984, the date of the Ms. Davis' bankruptcy filing, the case had been briefed and argued but the Supreme Court had not rendered a decision (ROA 360, 128). The Supreme Court affirmed the Commonwealth Court by an equally divided vote (ROA 128-130). Justice Hutchinson, who cast the deciding vote, stated "On the particular facts of this case I believe the evidence is sufficient, albeit barely..." to support the Commission's finding of discrimination (ROA 130).

TWA applied for reargument out of time which was subsequently allowed (ROA 139-140). Liability was finally established when, on October 1, 1986, the Supreme Court dismissed TWA's appeal (ROA 141).

After Freeland & Kronz received wage information from TWA, they submitted an "estimate of damages" to TWA in early May of 1987 (ROA 76-79). This estimate claimed losses for "back pay" (wage loss prior to May, 1987), "front pay" (wage loss from May, 1987 through June, 1990) and "pension loss." The parties held a settlement conference with Commission officials on May 15, 1987 (ROA 325-326). Commission officials believed it would be difficult for the debtor to

show an entitlement to any damages after TWA underwent substantial staff reductions in Pittsburgh in 1980 (ROA 342-343). If the Commission did not change its position on damages, Ms. Davis would be entitled to $11,219.00, excluding interest, according to Freeland & Kronz's estimate (ROA 76-79).

By August of 1987, the parties had worked out most of the details of a settlement (ROA 345). They then agreed that one-half of the payment to the debtor in the settlement would be identified as "tort recovery" (ROA 80). The settlement was formalized by a September 11, 1987 agreement which called for the payment of $23,483.75 to the debtor for "back or front pay," $23,483.75 to the debtor for alleged "tort claims and other claims not represented by wage loss," and $63,032.52 to Freeland & Kronz for "attorneys' fees," $48,032.52 in cash, and $15,000.00 "worth" of travel vouchers (ROA 82-83).

Freeland & Kronz expended almost $69,000.00 worth of legal time on the lawsuit (ROA 96-99). Approximately sixty-nine (69%) percent of this time was expended prior to the bankruptcy filing, the remaining thirty-one (31%) percent was expended post-petition. Freeland & Kronz actually received $36,500.00 in attorneys' fees plus the repayment of costs and the travel vouchers (ROA 49, 41). This sum represents payment in cash of fifty-two (52%) percent of their time expended on the case.

The debtor received $32,159.50 from TWA which passed through Freeland & Kronz's bank account (ROA

93, 41). The debtor also received $16,114.75 directly from TWA after withholding taxes were paid (ROA 93, 41).

In the trial of this case ("*Taylor*") before the United States Bankruptcy Court for the Western District of Pennsylvania ("Bankruptcy Court"), Wendell Freeland and Richard Kronz were qualified as experts and testified that the lawsuit's fair market value, as of the bankruptcy filing, was $10,000 and $5,000, respectively (ROA 357-358, 369, 131-134). The trustee presented no expert testimony on the value of the TWA lawsuit. The Bankruptcy Court found that the lawsuit had a value of $110,000.00 on October 24, 1984. App. 40a.

The trustee thought of objecting to the debtor's claim of exemption in the TWA lawsuit but did not because he thought the lawsuit would be "a nullity" - there would be no recovery (ROA 243). The trustee never objected to the claim of exemption in the TWA lawsuit.

The Bankruptcy Court issued an order, dated and entered June 28, 1991, which stated that the estate of the debtor has been fully administered and "Robert J. Taylor, Esquire is discharged as trustee of the estate...the Chapter 7 of the above-named debtor is closed." The trustee did not appeal this order. The case has not been reopened as of November 5, 1991, though the (former) trustee has filed a Motion to Vacate Case Closing Order Nunc Pro Tunc. Freeland & Kronz has objected to this Motion alleging the trustee lacks standing to request such relief.

SUMMARY OF ARGUMENT

The Court of Appeals for the Third Circuit properly construed § 552(l) of the Bankruptcy Code and Bankruptcy Rule 4003(b)(3), and held a debtor's claim of exemption is not subject to attack unless someone objects to the claim within thirty (30) days of the mandatory "§ 341 meeting." This view is supported by the clear text of the Code, its legislative history and strong policy reasons. The debtor must know what property is available for her fresh start; the trustee must know what assets to administer and distribute.

The conflict in the Circuits on this issue is minimal. The three cases offered by the petitioner to support a conflict are factually distinguishable from this case. The trustee, in *Taylor*, never objected to the claim of exemption. He did not take action against the exempt property until three years after the debtor's discharge.

This case could be resolved on other grounds. This Court could determine that Ms. Davis had a "good faith statutory basis" for her claim of exemption. The Court would have to review valuation evidence and decide state law issues to make such a determination, an inappropriate exercise of its "extraordinary jurisdiction."

This case is of limited procedural importance, may be moot and the trustee lacks standing to bring this action.

REASONS FOR DENYING THE WRIT

I. THE DECISION BELOW WAS CORRECT AND JUST.

In *Taylor*, the United States Court of Appeals for the Third Circuit ("Third Circuit") held that § 522(l) of the United States Bankruptcy Code, 11 U.S.C. §101 *et seq*. (1988), ("Code") and Federal Rules of Bankruptcy Procedure 4003(b) and 9006(b)(3) ("Rules"):

> establish a strict procedure for objections to claimed exemptions. Their import is clear and they admit of no exception. Unless the trustee or another party objects to the debtor's claimed objections within a thirty-day period following the creditor's meeting or the amendment, the property claimed exempt by the debtor is exempt. No provision of the Code provides that failure to object is excused when the debtor's exemption claim is not advanced "in good faith," nor is there an exception provided for situations where a claimed exemption has only a questionable basis in Section 522(b)...Nothing in the legislative materials suggests that any exceptions to the bright line rule were intended.
>
> App. 6a, 11a.

The Third Circuit further held:

> where "the terms of a statute [are] unambiguous, judicial inquiry is complete except in rare and

> exceptional circumstances" ... where "the literal application of a statute will produce a result demonstrably at odds with the intention of the drafters" ... a result "so bizarre that Congress 'could not have intended' it." ...
>
> This is not one of those "rare" cases.
>
> App. 10a.

The result in this case is just. Attorneys, who prosecuted a lawsuit through three appellate courts in Pennsylvania for almost seven years, should be allowed to retain their fee.

Any other result would be patently unjust. A trustee, who took no timely legal action against a debtor's claim because he thought it was a "nullity," should not be allowed to deprive the attorneys of their fees for producing a substantial recovery for their client. If the trustee doubted the basis of the exemption claim, he could have objected. If the trustee had objected, the Bankruptcy Court would have protected Freeland & Kronz's fees as a matter of course.

II. ANY CONFLICT IN THE CIRCUITS IS NOT SQUARE OR IRRECONCILABLE.

Petitioner notes that, in addition to the Third Circuit, five other Circuit Courts have commented on this issue. *Clark v. Brayshaw (In re Brayshaw)*, 912 F.2d 1255 (10th Cir. 1990); *Halverson v. Peterson (In re Peterson)*, 920 F.2d 1389 (8th Cir. 1990); *Sherk v.*

Texas Bankers Life & Loan Ins. Co. (In re Sherk), 918 F.2d 1170 (5th Cir. 1990); *In re Brandstaetter*, 767 F.2d 324 (7th Cir. 1985); *Munoz v. Dembs (In re Dembs)*, 757 F.2d 777 (6th Cir.1985).

Both *Brayshaw* and *Brandstaetter* support the Third Circuit's construction of § 522(l) of the Code and the Rules. In the two of the three remaining cases, *Dembs* and *Peterson*, the exemptions, as claimed, were allowed. *Dembs*, 757 F.2d at 781; *Peterson*, 920 F.2d at 1395. Each of these three cases, *Dembs*, *Peterson* and *Sherk*, is further distinguishable from *Taylor*.

Rule 4000(b)(3) took effect five months after debtor's claim of exemption in *Dembs*, but during the pendency of the case. The Sixth Circuit declined to apply the rule retroactively. *Dembs*, 757 F.2d at 780. The Court, in dicta, approved of the "good faith statutory basis" standard but allowed the exemption because the creditor's action against exempt property was three months after discharge. *Id.* at 781. *See also Harris v. Manufacturers National Bank of Detroit*, 457 F.2d 631 (6th Cir. 1972). In *Taylor*, the trustee did not take any action against the claimed property for three years after discharge.

In *Peterson*, the Eighth Circuit allowed the debtors' claim of a Minnesota homestead exemption in a dwelling when the debtors did not own the underlying land. The trustee's objected to the debtors' claim four days late. *Peterson*, 920 F.2d at 1390, 1395. In *Taylor*, the trustee has never objected to the debtor's claim of exemption.

In *Peterson*, the Eighth Circuit looked at whether the debtors had a "good faith statutory basis" for their claim of exemption - *not* the "merits" of the exemption. The Court reasoned that "given the liberal Minnesota homestead exemption policy and the unclear state law ... the debtors had a good faith statutory basis for their claimed exemption." *Id.* at 1394.

In *Taylor*, the petitioner assumes that the debtor did not have a "good faith statutory basis" for her claim of exemption. Ms. Davis had an absolute entitlement to $4,150.00 in "any property" under § 522(d)(5) of the Code. She also had an absolute entitlement to payments in compensation for loss of "future earnings" under § 522 (d)(11)(E) of the Code. She had an arguable basis for exempting some of the proceeds of the lawsuit for alleged "pension loss" under § 522 (d)(10)(E) of the Code.

Depending on the value of the TWA lawsuit at the bankruptcy filing, and how much was fairly attributable to "future earnings" and/or "pension loss", the TWA lawsuit should have been exempted on the "merits" of the exemption. The Bankruptcy Court's conclusion that the lawsuit was worth $110,000.00, on October 24, 1984, was a "clearly erroneous" factual finding and an inquiry into the "merits" of the exemption not sanctioned by *Peterson*, *Dembs* or *Sherk*. The Third Circuit did not reach the issue of valuation error in *Taylor*. App. 15a.

In *Sherk*, the Fifth Circuit denied the debtor's exemption claim in property that had been foreclosed

upon before bankruptcy. The Court conceded that, if the debtor had been in possession of the homestead property, he could have validly exempted it from the bankruptcy estate. *Sherk*, 918 F.2d at 1175. The Fifth Circuit held that the exemption claim was really a "fraudulent transfer" action which belonged to the trustee, not an exemption claim belonging to the debtor. *Id.* at 1175. The claim to recover the property was denied by the district court and the Fifth Circuit affirmed. *Id.* at 1173, 1178.

Section 522(l) of the Code does not allow the debtor to create an interest in property, it only allows her to exempt the interest she had as of bankruptcy. Ms. Davis had a present interest in the TWA lawsuit at the time of the bankruptcy filing, unlike the debtor in *Sherk*. The trustee did not contest the debtor's interest in the lawsuit.

III. THIS CASE COULD BE DECIDED ON OTHER GROUNDS

This case could be decided on grounds other than those asserted by the petitioner because:

(1) the trustee never objected to the claim of exemption, even after the discharge of the debtor, *see Dembs*;

(2) debtor had a present interest, at the time of the bankruptcy filing, in the property that she claimed as exempt, *see Sherk*;

(3) the debtor had a "good-faith statutory basis" for her claim of exemption in any property up to a value of $4,150 and for "future earnings" if the errors below on judicial estoppel and valuation are rectified. *See Peterson*, *Dembs* and *Sherk*.

The cases, relied on by the petitioner to show a conflict in the Circuits, are distinguishable from *Taylor*.

IV. THIS COURT WOULD BE REQUIRED TO RESOLVE EVIDENTIARY AND STATE LAW ISSUES NOT DECIDED IN THE THIRD CIRCUIT.

The Third Circuit did not resolve three issues raised by the respondents which would determine if the debtor had a "good-faith statutory basis" for her claim of exemption. The issues were:

(1) The lower courts erred as a matter of law in including attorneys' fees in the valuation of the lawsuit because (a) the pre-petition attorneys' fees were protected by an equitable lien under state law, (b) the post-petition attorneys' fees could not become property of the estate under § 541 of the Code and (c) the attorneys' fees were a separate element of the settlement;

(2) The lower court's finding that the lawsuit was worth $110,000.00, as of the bankruptcy filing, was clearly erroneous when the only competent testimony at trial valued it at nine (9%) percent of that amount; and

(3) The lower court erred in holding that Freeland & Kronz were judicially estopped from asserting that some of the lawsuit damages were for "future earnings" and "pension loss" because they characterized these damages as "tort recovery and other claims not representing wage loss" in a settlement agreement executed three years after the bankruptcy.

This Court would have to resolve these evidentiary, state law and federal common law questions in order to determine whether the debtor had a "good-faith statutory basis" for her claim of exemption. Her exemption claim had a valid statutory basis when made. The claim was valid on "the merits" years later depending on (1) lawsuit value as of October 24, 1984, (2) whether the attorneys' fees were part of the recovery, and (3) what portion of the value was attributable to "future earnings" (earnings after October 24, 1984) or "pension loss."

It would be inappropriate for a Court of "extraordinary jurisdiction" to have to resolve these issues as a prerequisite to deciding a procedural issue of limited applicability.

V. ANY CONFLICT IS MINOR AND PROCEDURAL.

The issues presented in this case, if and to what extent the time limit for objecting to claims of exemption should be extended and, if extended, what standards

should be used, are not important or substantial federal questions. This court must limit its "extraordinary jurisdiction" out of necessity to questions of more pressing substance. Conversely, it must tolerate some minor variance on procedural issues of limited applicability.

VI. THERE ARE SOUND POLICY REASONS FOR THE EXEMPTION PROCEDURE CONGRESS CREATED.

One of the primary purposes of bankruptcy is to provide a "fresh start" to debtors. *Perez v. Campbell*, 402 U.S. 637, 649, 91 S.Ct. 1704, 1706, 29 L.Ed 2d 233, 241 (1971). The purpose of exempt property is to allow the debtor to retain a minimal amount of property for his "fresh start." *Van Iperen v. Production Credit Assn. of Worthington-Slayton Branch (In re Van Iperen)*, 819 F.2d 189 (8th Cir. 1987); *see*, *In re Hindman*, 104 F. 331 (9th Cir. 1900). The exemption procedure Congress created with § 522(l) of the Code and Bankruptcy Rule 4003(b)(3) offers certainty and finality which is particularly acute in the bankruptcy context. App. 12a.

The debtor must begin his "fresh start" and must know what property he has available for that purpose. The trustee must administer assets according to the Bankruptcy Code. The procedural rules make imminently good sense, given the framework which the Code establishes for administering assets of the estate. *Doyle v. Grossman (In re Grossman)*, 80 B.R. 311, 314 (Bankr. E.D.Pa. 1987).

In *Brandstaetter*, the Seventh Circuit expressed another policy concern applicable in *Taylor*:

> It would be questionable policy to allow the trustee to hang back while the debtor goes forward with his ... claim and then subsequently object to the inclusion of these claims in exempt property.

Brandstaetter, 767 F.2d at 328.

Courts that have opted for the "good faith statutory basis" standard have ignored the policies of certainty and finality, necessary to give the debtor a true "fresh start."

VII. THIS CASE MAY BE MOOT; ROBERT TAYLOR LACKS STANDING TO MAINTAIN THIS ACTION.

The Bankruptcy Court issued an order, dated and entered June 28, 1991, which discharged Robert J. Taylor, Esquire as trustee of the estate of Emily Davis and ordered the case of the debtor closed. The trustee did not appeal the case closing order. The case has not been reopened, however, the former trustee's counsel has filed a motion to vacate the case closing order nunc pro tunc.

Respondents have objected to this motion on various grounds, including that Robert Taylor has no standing to request such relief. It is the duty of the Office of the United States Trustee, under § 703(c) of

the Code, to appoint a successor trustee if a trustee is needed in a reopened case under § 350 of the Code.

CONCLUSION

For the foregoing reasons, the petition for certiorari should be denied.

Respectfully submitted,

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